

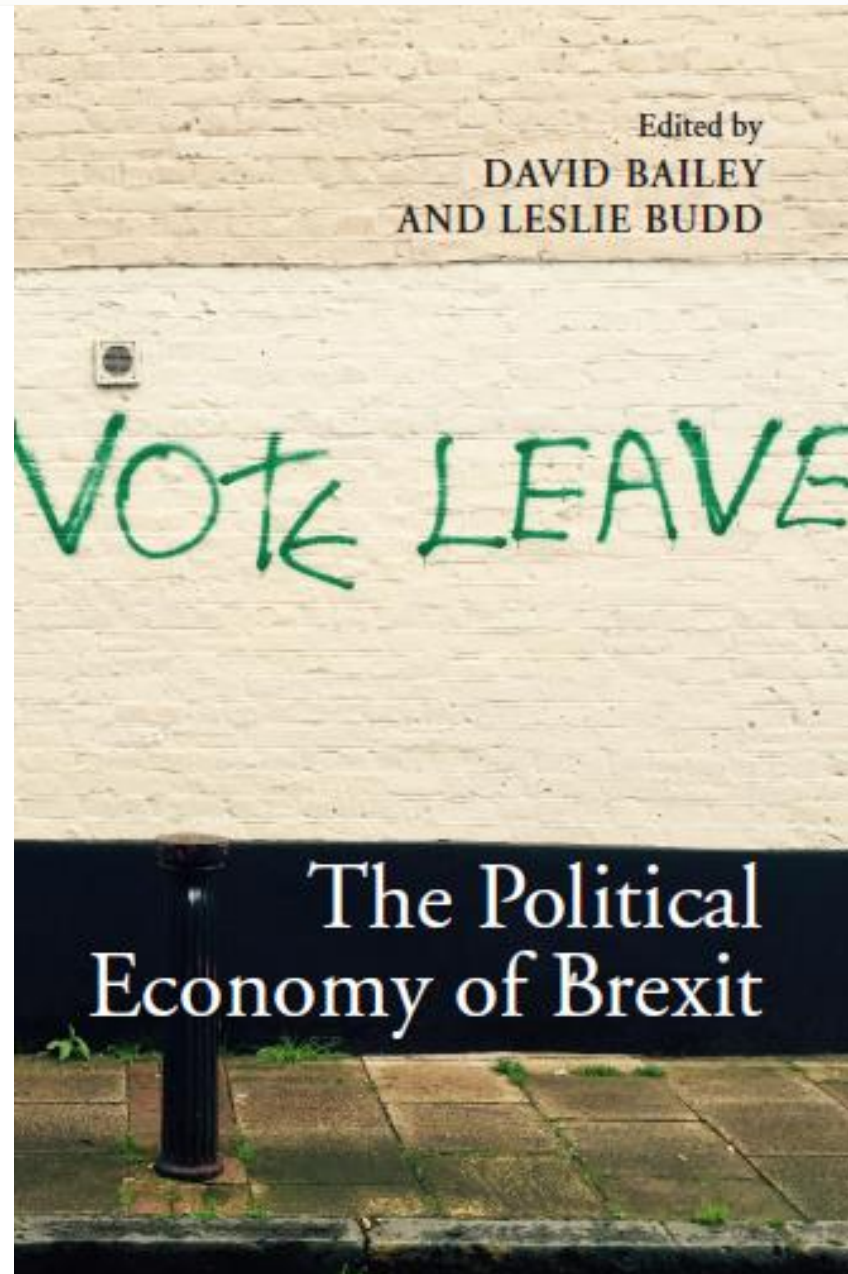
Brexit, UK Auto & Industrial Policy

*Brexit and the North of England
Newcastle, November 2017*

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*Agenda
Publishing*

2017

- Long term impact of Brexit will depend on a range of factors:
- 1. Trading arrangements between the UK and remaining EU countries. These have to be negotiated after Article 50 was activated earlier this year.
- 2. Actual economic policies adopted by the UK government after we leave.
- → a range of possible outcomes... most economists think that leaving **will come at *some* economic cost**

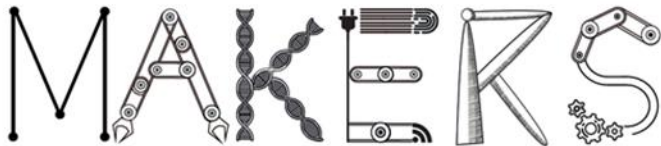
- FT survey of 100 economists last year: three-quarters thought leaving would reduce size of the economy in the medium term compared to staying in. Less than one in ten thought it would improve growth.
- Three studies published last year:
 - Centre for Economic Performance (LSE)
 - Price Waterhouse Coopers for the CBI
 - Oxford Economics

- All 3: Brexit will have some negative impact on the UK economy compared to staying in.
- BUT impact is *smaller the closer any new arrangements are to our current economic relationship with the EU*.
- Estimates range from near zero (if stay in Single Market, + allow free movement of labour...) to significantly *negative* if leaving results in substantial new barriers to trade.
- Treasury Study: 6% smaller by 2030. OECD, IMF
- NIESR: GDP could be 1.5-7.8% lower by 2030 + “substantial loss of export trade”.
- **Cost of leaving Single Market:** 4% by 2030? (IFS)

- EU is the UK's major trading partner: 45% UK exports & 53% UK imports of goods & services in 2014
- EU is the largest source of inward investment in UK. In 2013, EU countries accounted for £453bn worth of the stock of inward FDI, or **46% of the total.**
- UK accounts for 16% of EU exports (US 15%, China 8%)
- **UK trade with EU accounts for 12% of UK GDP; EU trade with UK accounts for 2% of EU GDP.**

Leave's incompatible Big Asks?

- A Free Trade Agreement for Goods and Services
- A Free Trade Agreement for Capital
- Restrictions on Labour Migration
- No EU budget payment
- Free from EU regulation on goods, labour and capital...



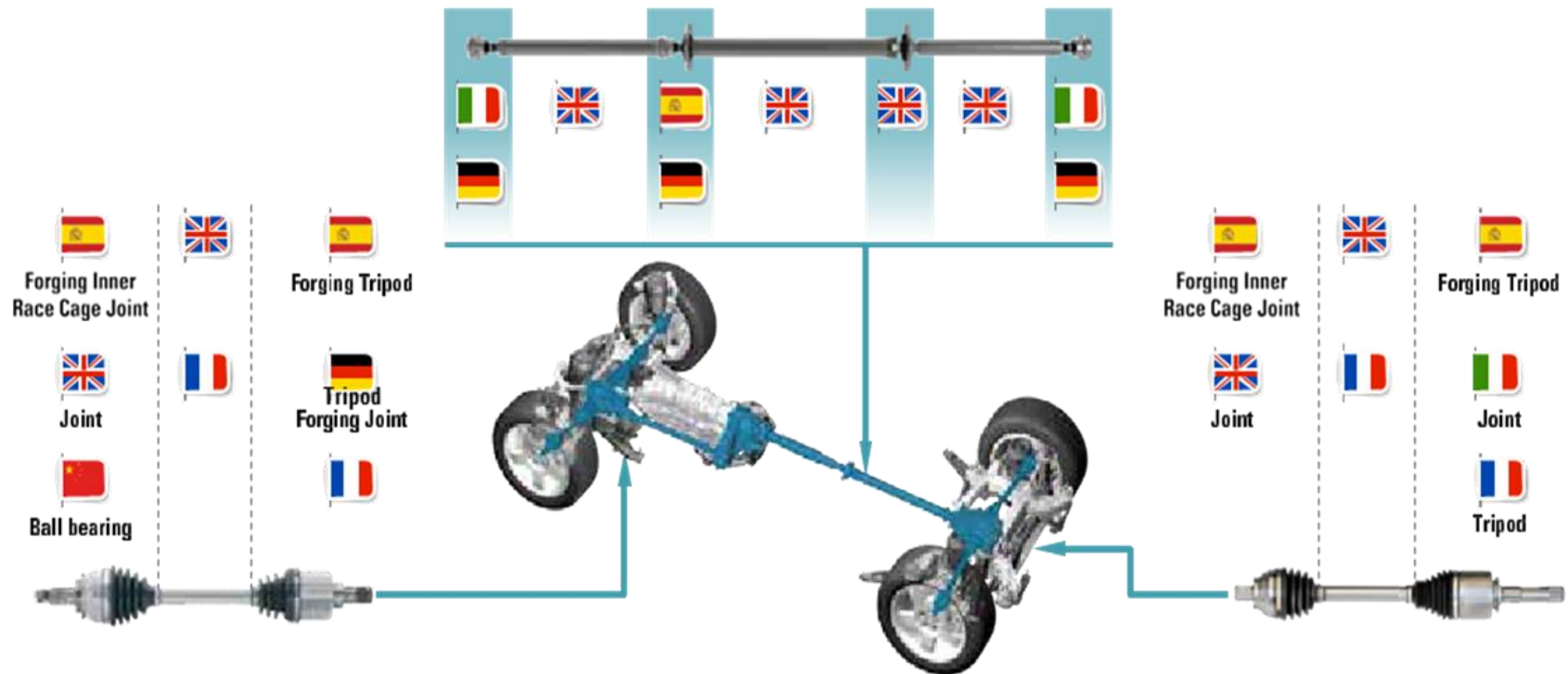
- **EEA (Norway):** gives access to single market in return for a 'price': a financial contribution + acceptance of EU regulations + *free labour mobility*
- **EFTA (Switzerland):** trade deals on a sector by sector basis. Financial contribution + *free lab mobility*. UK: free trade deal with EU + better access for financial services?
- **Customs Union (Turkey):** customs union with EU, no tariff barriers in manufactured goods.
- **Bilateral Agreement (Canada):** bilateral style trade deal, eliminates tariffs, better IP protection, and 'ISDS' provision
- **WTO:** Unilateral approach - UK relies on membership of WTO.

Case study

GKN Driveline – Illustration of an integrated supply chain

A typical driveline system produced by GKN incorporates specialist parts largely from the rest of the EU.

GKN sources specialist forged parts from Spain, Italy, France and Germany which are then assembled at GKN Driveline's factory in the UK and supplied to UK and EU OEMs.

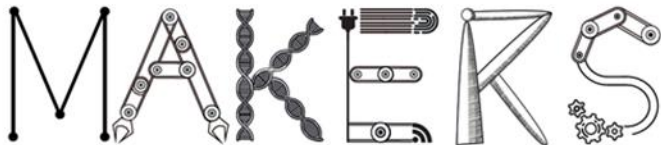


KPMG (2016): In the event of Brexit...

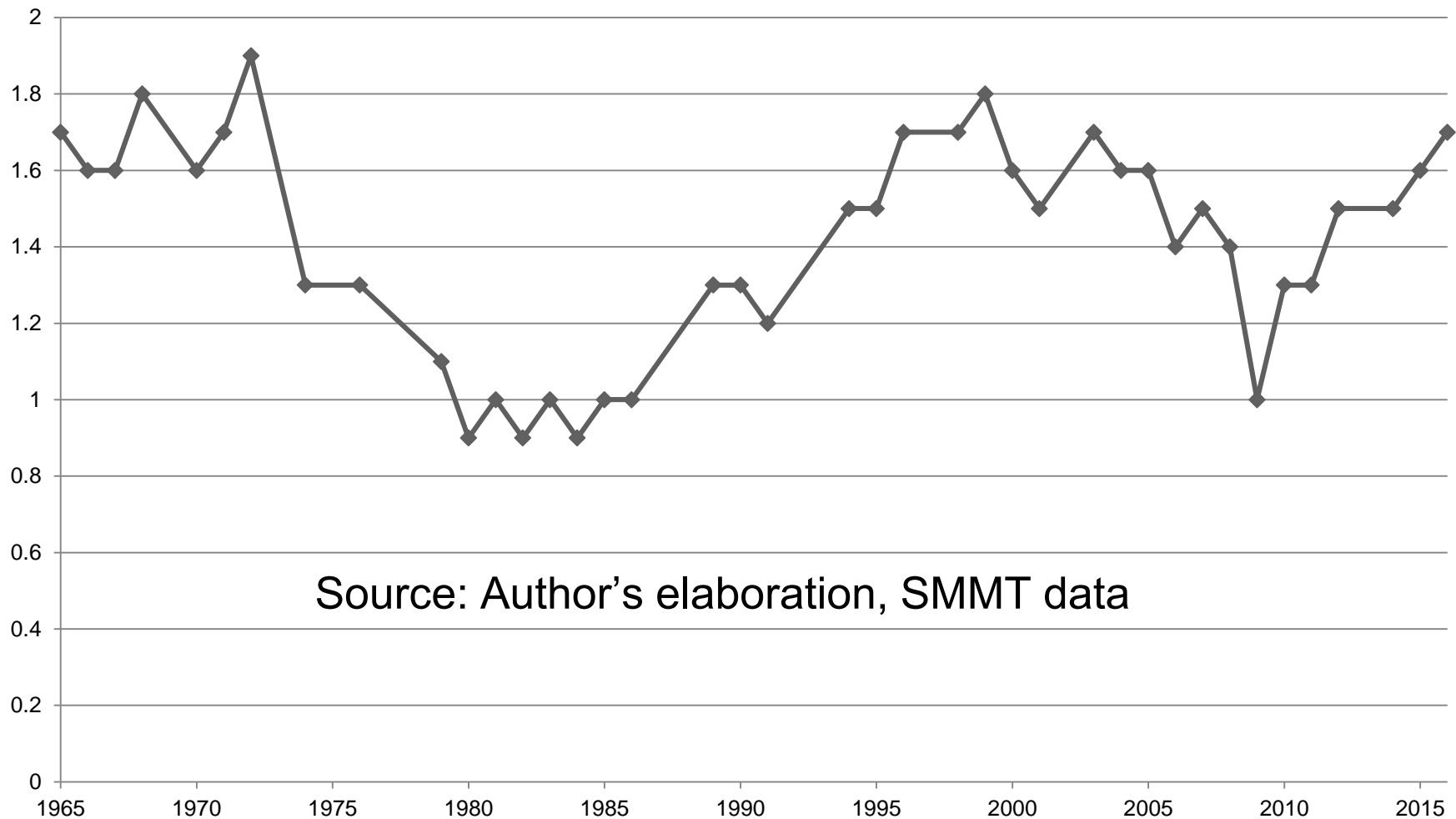
- *“Original equipment manufacturers such as aircraft and automotive manufacturers could perhaps favour the simplicity and flexibility of an EU-supply base rather than dealing with the potential complexities of a company based outside the union. In the long term, more EU-based alternatives would emerge. **As buyers churned their suppliers, UK firms might become more marginalised. The integration of supply chains is a double edged sword – our manufacturers are not indispensable**”.*

Automotive Industry: consensus on benefits of Europe for UK (SMMT, 2016)

- Single Market
- Shaping Regulations
- International Trade Deals
- Accessing skilled workers
- R&D funding



UK Car Production - units (m)

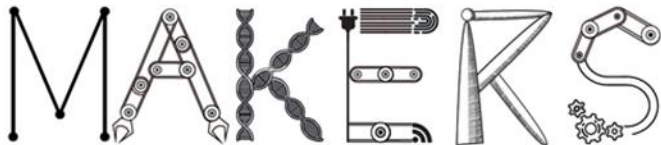


Other auto assembly 'success' indicators

- Over **£8bn** invested in UK auto sector in last 3-4 years
- Some plants have gone to 24/7 working with **3 shifts** (Halewood, Sunderland) – others (JLR) working very flexibly
- 80% of UK produced cars exported. now c12% value of all exports (trade deficit in 2007 of £7.5bn).
- **c57%** of exports go to EU. Plant utilisation rate in UK > 70%
- highest productivity in Europe
- UK engine production 2.5m + in recent years and rising (JLR)
- Broader industry employs c800,000 people
- Strong productivity growth, unlike much of UK economy

Other auto assembly 'success' indicators 2

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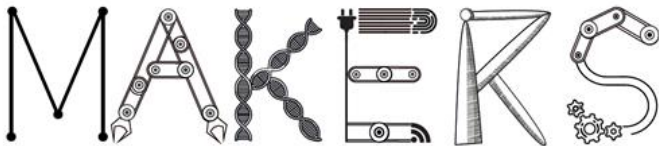
What underpins this recent auto success?

- Being part of Single Market
- skilled and flexible workforce – unions key part of the ‘solution’
- what’s left is genuinely ‘world class’
- The shift ‘up market’ (2020: 54% premium, 27% mid market SUVs/crossovers, 19% mid market)
- exchange rate depreciation over 2008-9 really helped re exports. Unwound until late 2015. Last year, post-Brexit vote: depreciation again
- Emerging economy success –middle class +
- Industrial policy did help, up to a point...

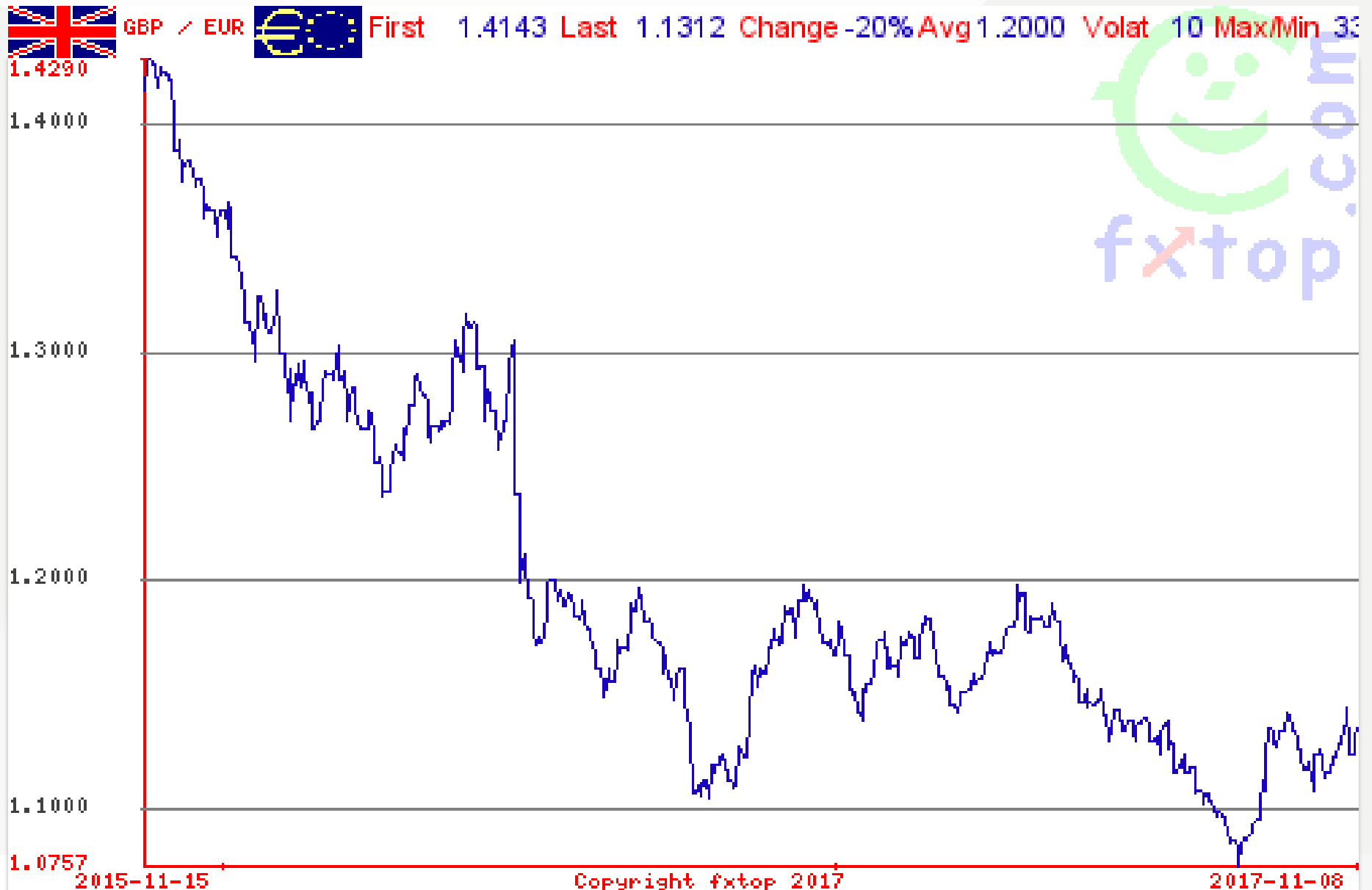
2016 Figures....

Production in the UK	Total Exports	Exports to the EU	Registrations in the UK	Imports from EU (or taken from stock)
1.72m	1.35m	0.76m	2.69m	2.22m


- Impact of Brexit on UK industry could be felt via: economic growth, investment delays, shifting cost bases, export disruption (and policy measures).
- Policy intervention: monetary policy easing by Bank of England

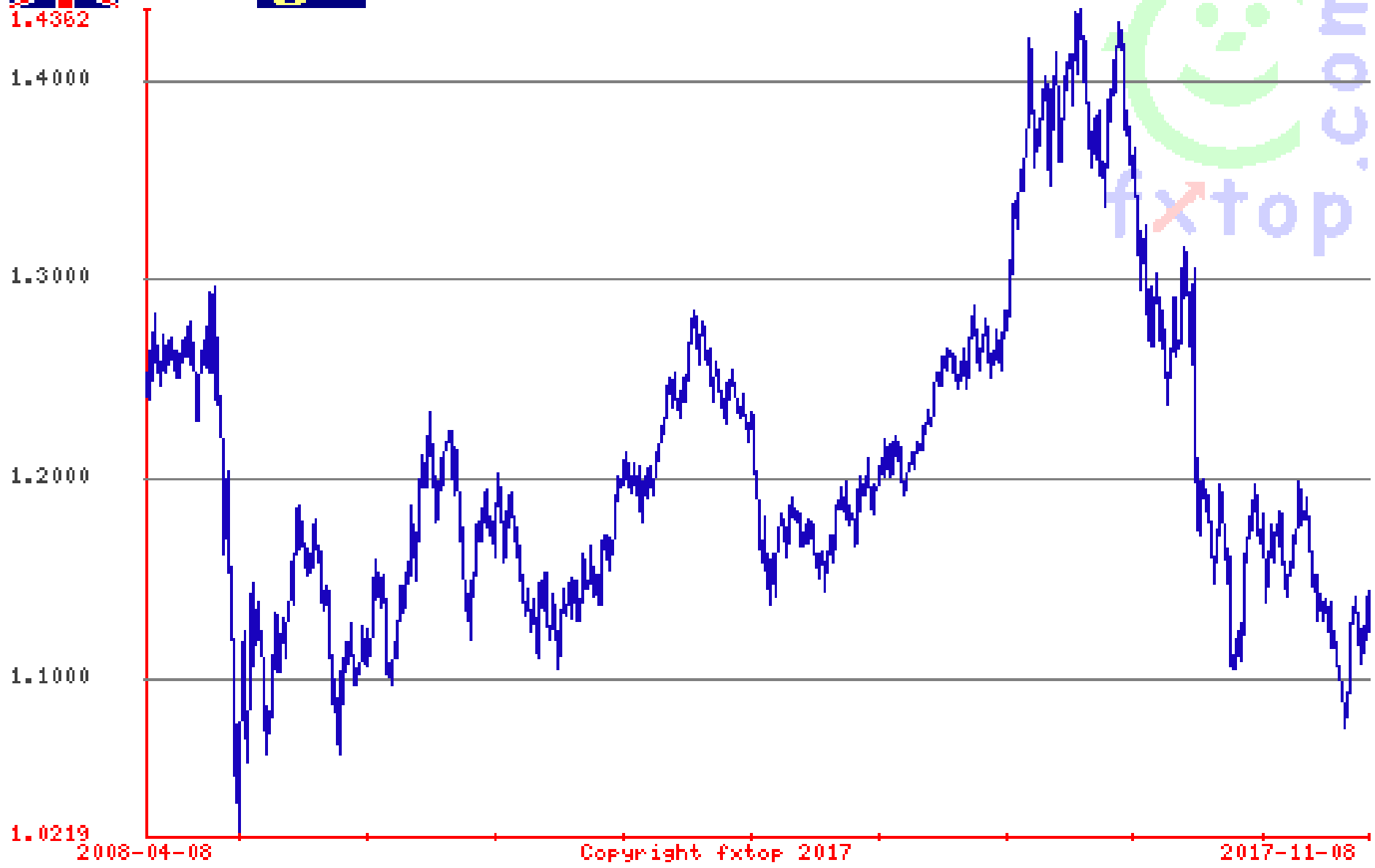


Sterling/Euro depreciation since late 2015

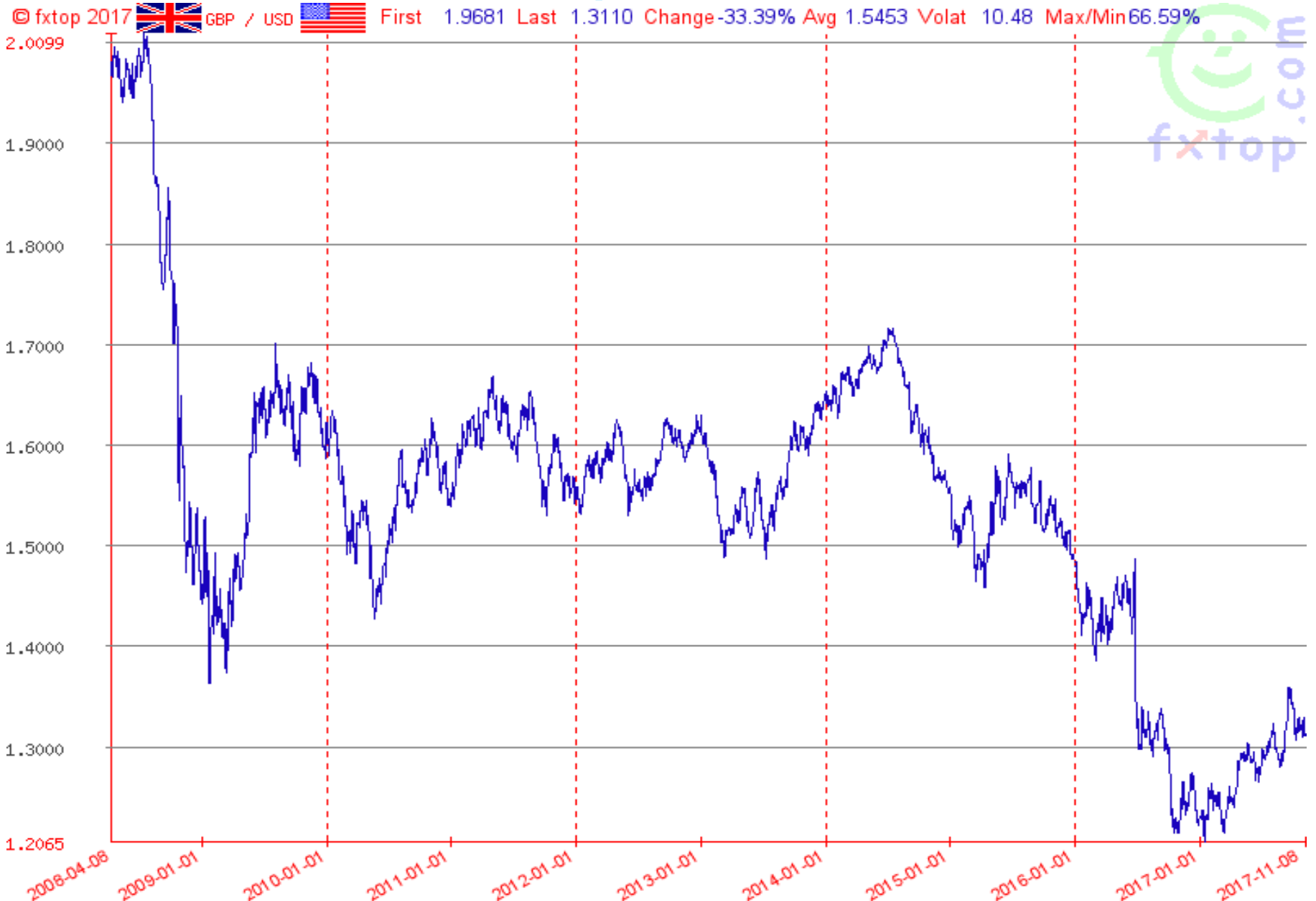


Back to levels last seen in Global Financial Crisis

 GBP /  EUR First 1.2541 Last 1.1312 Change -10% Avg 1.2080 Volat 9 Max/Min 41%



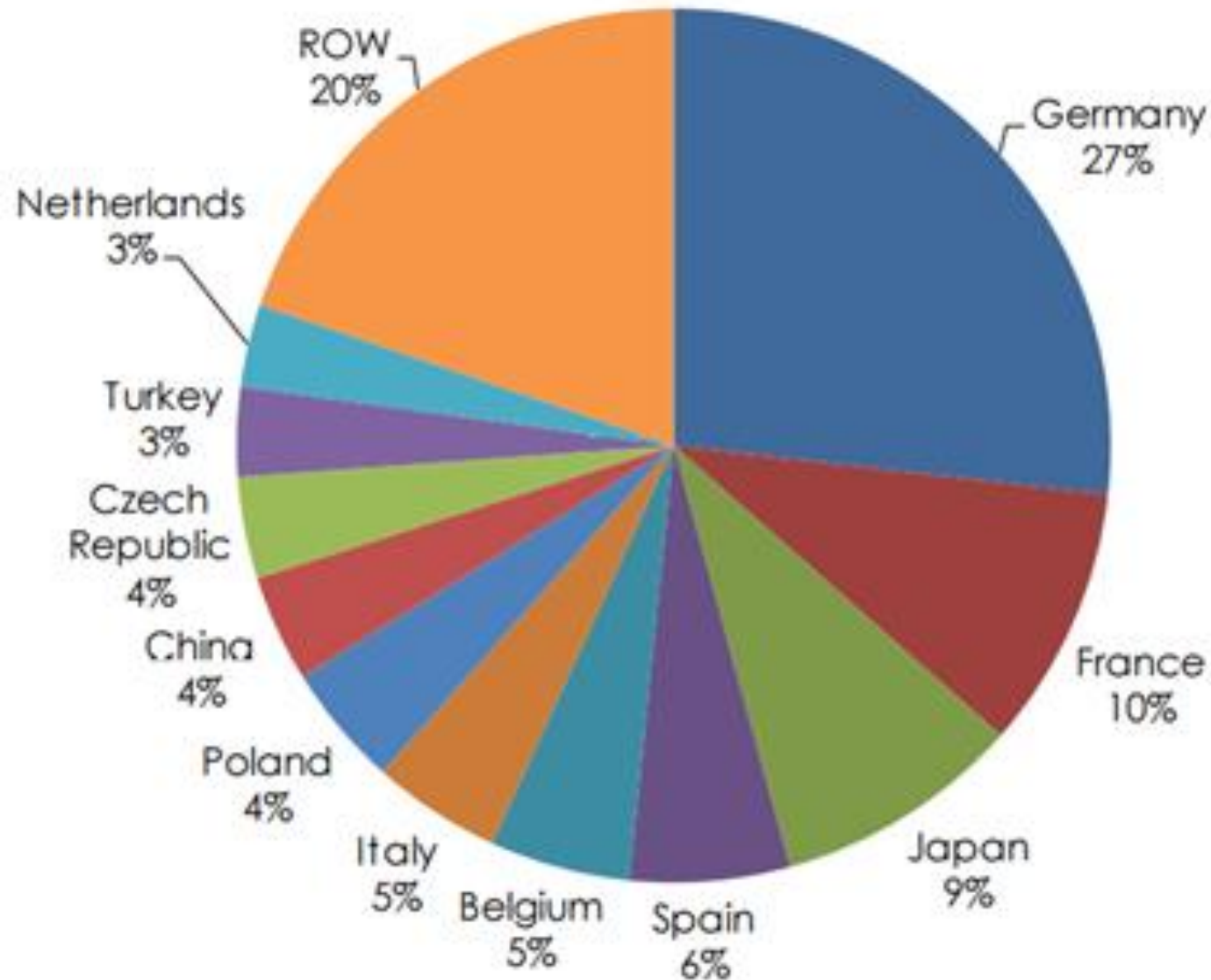
£/\$ even more marked depreciation



Brexit: Some economic impacts on UK auto?

- Slower growth → lower cars sales in UK (-5 to -10%?)
- Depreciation of sterling: Imported cars more expensive. **Profitability of UK plants?**
- Depreciation of sterling: **boost to exports** (*BUT imported components more expensive*).
- Opportunity for **more reshoring** of components supply? BUT slow: need policy to push this along
- Challenges for suppliers using East European labour
- Foreign investment?
- **Short term impact likely to be: lower UK car sales but output up, and likely profitability up**

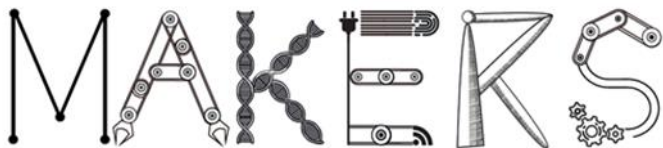
Automotive component imports (Davis et al 2014)

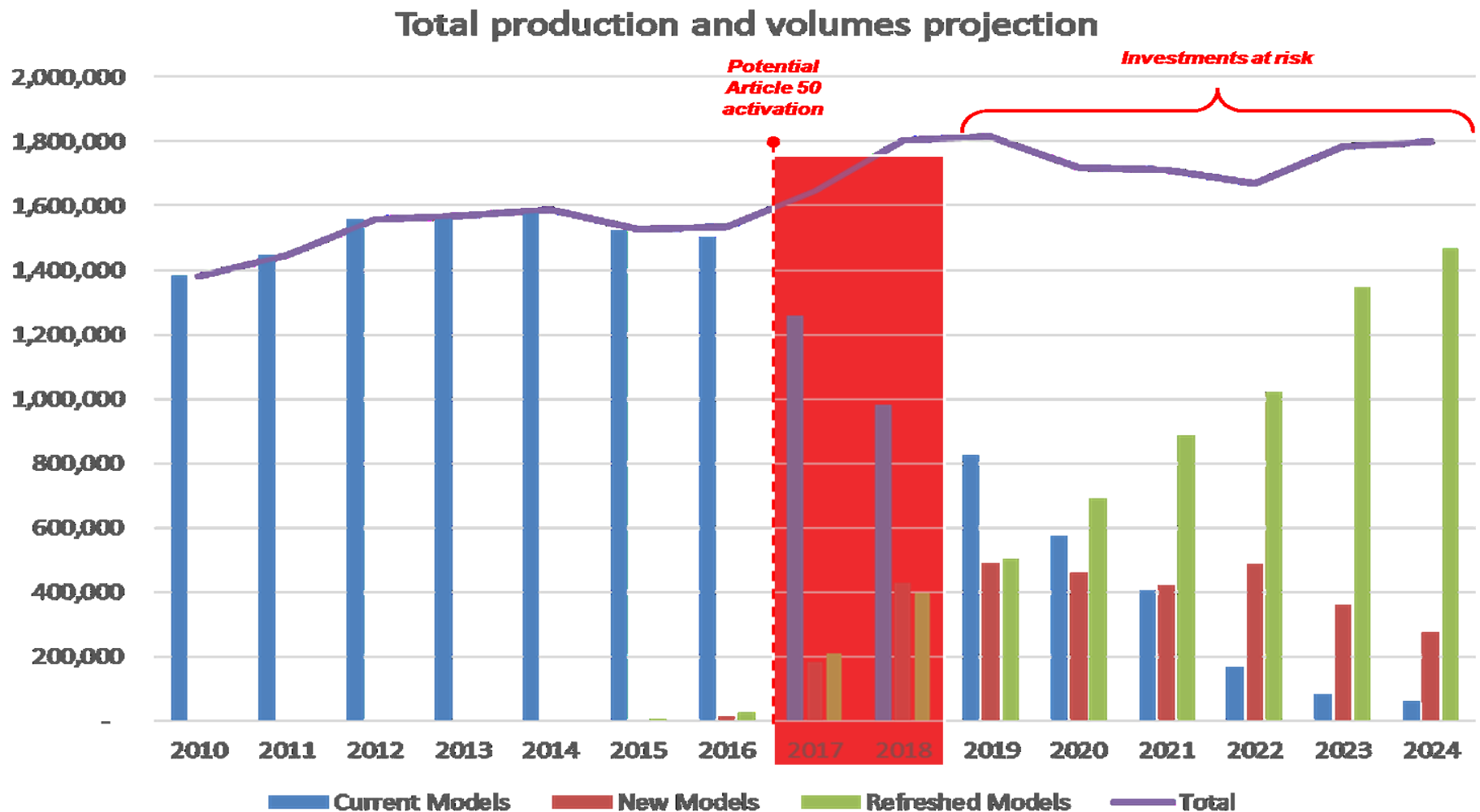


- Possible **short term boost** offset by **uncertainty** over UK trading position with EU.
- Uncertainty: big deterrent to foreign direct investment.
- Comments by Japanese government, Nissan and Honda
- Senior manager, UK car plant: *“At the point when we need the next round of investment, if we can’t compete and if the British government doesn’t help us then I will be very, very worried... we have to make a decision that makes economic sense.”*

- Tim Lawrence (Head of manufacturing at PA Consulting):
- *“The current lack of certainty about tariffs places a question mark over the future of a significant number of UK plants and jobs. As the supply chain investment tends to move with Original Equipment Manufacturers’ volumes, the impact on UK jobs and the economy will be felt beyond the automotive industry.”*

1. Uncertainty during talks the between the UK and the EU over Brexit — Article 50 activated in May 2017 and two tear countdown clock in ticking — could see auto makers place work on model upgrades or new models at non UK plants;
2. If UK's access to the EU single market after Brexit is seen as inadequate by auto makers, then they might close some of their UK factories.





Source: **PA Consulting**, 2016. *Brexit: the impact on auto manufacturing in the UK*

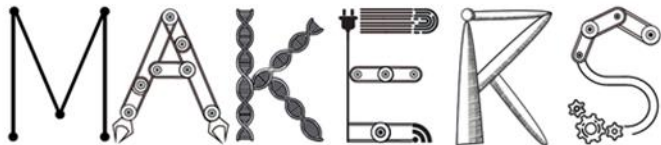
Upcoming model upgrade decisions

	2017	2018	2019	2020	2021	2022	2023	2024
Honda	Civic						Civic	
GM (Vauxhall)					Astra		MPV	
BMW (Mini)		Countryman				Clubman	Mini	
Toyota		Auris Avensis				Auris		
Nissan	Leaf Juke	Note		Qashqai XTrail	Infinity Q30			
Tata (Jaguar)	XJ				F-Type	XF /XE	F-Pace	XJ / XJR
Tata (Land Rover)		Evoque	New Defender	Range Rover Sport		Discovery Sport		Evoque Discovery

Source: adapted from PA Consulting (2016)

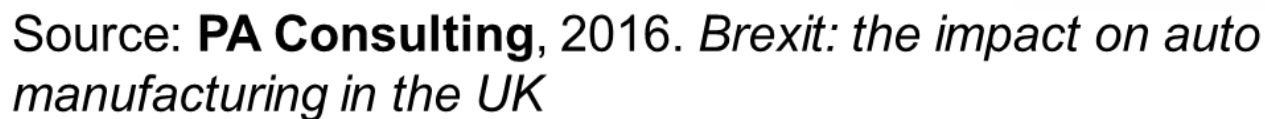
Assemblers examining assembly location will consider a range of issues:

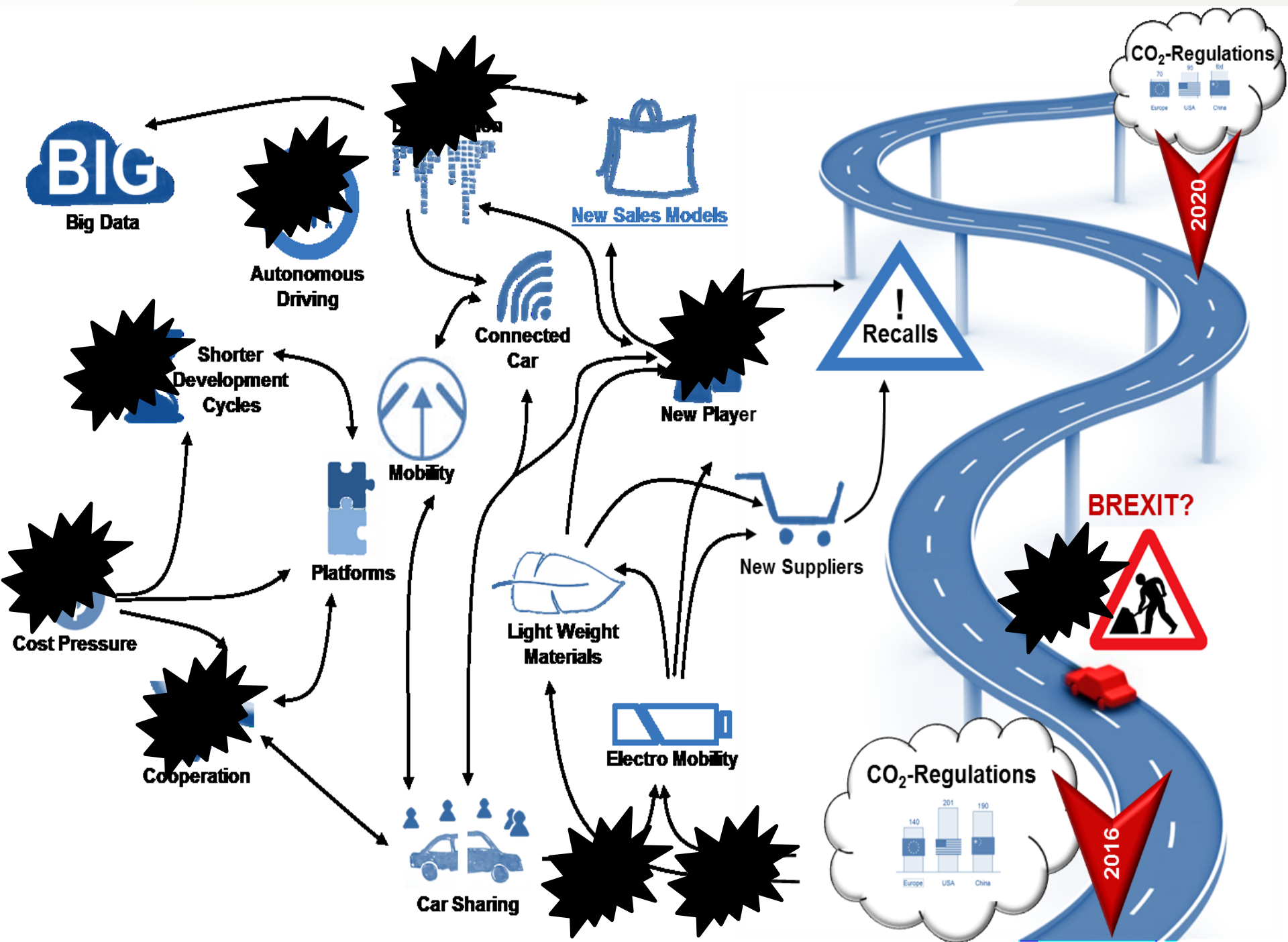
- Relative cost differences between UK and EU locations
- How dependent are sales on the European vs UK market?
- Relative importance of “Made in Britain” to the brand
- Volume of imported components
- Switching options in the EU
- Profitability of UK operations
- Plus: ease of exit from UK as against other countries?



- Reality of trade offs?
- Is No deal really 'better than a bad deal'?
- Leaving the Single Market will likely increase long term economic costs of leaving the EU
- Probably more likely that the UK changes its economic model ?
- Leaving the customs union? Likely that complex sector by sector deals will be needed
- Free Trade Agreement will also need a regulatory agreement: Rules of Origin, conformity of assessment. → International supervision

- Skills
- Regulation
- Access to research networks and funding





Some immediate priorities to consider:

- Impact of Brexit on UK industry could be felt via: economic growth, investment delays, shifting cost bases, export disruption (and policy measures).

Need?:

- Prioritise Single Market in negotiating position with the EU or at least Customs Union +;
- Being able to hire skilled workers from EU;
- Exploiting opportunities: needs an industrial policy for auto & manufacturing.

What's to be done?

- Eliminate uncertainty over trade position as soon as possible
- Make the most of **opportunities** to export and reshore components supply
- Boost capital allowances rather than general cut to corporation tax?
- 'Re-boot' industrial policy and funding:
 - More to rebuild supply chain – *reverse previous mistakes*
 - Skills and finance – **devolution to regions.**
 - Support for exporters
 - Attracting tier 1s? Segments of supply chain.
 - Innovation eg 'phoenix industry'
 - Energy costs? Proper compensation scheme.

Need to join up sectoral industrial policy and technology policies with place based approaches at regional level.

Thanks for listening

- Comments and questions welcome
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